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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission

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COMMISSIONERS

MAR 28 2007

MIKE GLEASON, Chairman
WILLIAM A. MUNDELL
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AZ CORP COMMISSION
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IN THE MATTER OF THE FILING BY
TUCSON ELECTRIC POWER COMPANY TO
AMEND DECISION NO. 62103.

DOCKET NO. E-01933A-05-0650

**STAFF'S COMMENTS ON TUCSON
ELECTRIC POWER COMPANY'S
SUBMISSION OF PROPOSED OPINION
AND ORDER AND RESPONSE TO
ACCOMPANYING PLEADING**

I. INTRODUCTION

Having reviewed Tucson Electric Power Company's ("TEP" or "Company") proposed Recommended Order and the pleading that accompanied its filing, Staff is concerned that the TEP filing is not consistent with our understanding of the agreement among the Parties. Staff's concerns fall into three categories: First, Staff is concerned with the tone and tenor of the pleading that TEP submitted to accompany its proposed form of order. Secondly, Staff believes that TEP has mischaracterized the nature of the proceeding that is to occur before the Commission. Finally, Staff notes that there are certain areas in which we have substantive disagreement with TEP's proposals. While Staff is in agreement with the notion that rates be held constant during the rate case, that is that rates not be allowed to decline by the elimination of the Fixed CTC during the pendency of the rate case, Staff has concerns about the process described by TEP to accomplish the possible refund of those revenues if the Commission should determine that they should be refunded. Also, while TEP proposes that the DSM and Renewables programs should be addressed in a separate docket, TEP fails to offer a specific proposal by which the costs of approved DSM programs might be capitalized and recovered later pursuant to a Commission-approved accounting order, or other mechanism. Staff concurs that implementation of TOU rates that have the effect of raising customers rates can only be accomplished in the rate case order that is anticipated to result from the agreed upon process.

1 By way of response to TEP's filing, Staff submits this pleading, containing comments on our
2 concerns with TEP's pleading and the misconceptions in the proposed form of order. Staff would
3 urge the Administrative law Judge to propose a recommended Opinion and Order that is consistent
4 with these comments in lieu of the one submitted by TEP.

5 **II. OVERVIEW**

6 At the conclusion of the hearing in this matter, the Parties agreed that TEP would submit a
7 form of a Proposed Recommended Opinion and Order that would embody a general agreement that
8 had emerged during the course of the proceeding. In Staff's view, all Parties recognized that the
9 Commission's consideration of the issues raised by TEP's Motion to Amend Decision No. 62103
10 could best be addressed in the context of a complete rate case filing on behalf of TEP. Staff further
11 believes that all Parties were in general agreement that TEP should be allowed to provide whatever
12 information it deemed appropriate and seek Commission approval for any of its proposed rate
13 treatments, including its request to have its generation priced at "market", its request for the
14 establishment of a regulatory asset as an accompaniment to complete traditional cost of service rate
15 treatment, its request for the establishment of an adjustor mechanism or ECAC, and its request for a
16 "hybrid" rate structure under which some of its generation would be deemed "competitive", while the
17 remainder would be the subject of traditional cost of service regulation. While no opinions were
18 offered regarding what would constitute adequate information regarding TEP's proposed
19 "competitive" alternatives, certain information seems indispensable. Market studies illustrating a
20 sufficiently robust market to support TEP's proposals would seem essential. Similarly, transmission
21 studies demonstrating that TEP has access to sufficient transmission facilities to permit its generation
22 needs to be met by competitive generation would seem to be another prerequisite. The Commission
23 would also need sufficient pricing information from which to conclude that rate impacts of such a
24 proposal would not be excessive.

25 In Staff's view, the agreed upon procedure would consist of a complete, traditional, cost of
26 service rate filing for all of TEP's property devoted to public service in the state. TEP would be
27 allowed to submit any additional information it wished to support its various requests for non-
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1 traditional rate treatment. In addition, the rate case would be processed without any Party
2 relinquishing any rights that might exist pursuant to TEP's 1999 Settlement or Decision No. 62103.
3 It is Staff's view that at the conclusion of the proceeding, the Commission will establish just and
4 reasonable rates for TEP. Consistent with A.R.S. §§ 40-253 and 40-254.01, Parties would have the
5 right to seek Rehearing of a Commission Decision, and ultimately have the right to appeal to the
6 Court of Appeals if they are dissatisfied with the Commission's Decision. In addition, Parties to the
7 1999 Settlement would retain any rights they may currently have under that Settlement and the
8 Commission Decision approving it, Decision No. 62103.

9 Finally, in Staff's view, it was anticipated that the proposed form of decision submitted by
10 TEP would include a recommendation that it be allowed to continue to collect revenue under the
11 Fixed CTC, pending resolution of the rate proceeding. Revenues from the Fixed CTC would be
12 subject to refund if the Commission's decision in the rate proceeding found it to be appropriate. It
13 was also anticipated that TEP would propose a methodology under which DSM, Renewables and
14 expanded TOU rate programs could be implemented, with the expenses incurred in connection with
15 those expanded programs being subject to an accounting order or other method of capitalization for
16 later recovery at the conclusion of the rate proceeding.

17 **III. TONE AND TENOR OF TEP'S PLEADING**

18 In Staff's view, the tenor and tone of TEP's pleading and Proposed Order is inconsistent with
19 the agreement among the Parties. The pleading contains numerous references to TEP's position in
20 the matter, all couched in such a manner as to convey the impression that other parties may agree
21 with them. For example, the very first sentence in the document asserts that "...various parties
22 expressed the view that, although one or more of TEP's proposals for a regulatory solution may have
23 merit, it was difficult to fully understand and evaluate the proposals without the information that
24 would typically be provided or obtained through a general rate case." Staff completely disagrees
25 with this description of the parties' positions. In fact, other than TEP, Staff believes that the parties
26 to this proceeding believe that a general rate case is necessary to establish rates for TEP that are
27 different than the ones they currently operate under, to wit, their standard offer rates minus the CTC
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1 components. It is certainly Staff's belief that, in the absence of a rate proceeding, starting January 1,
2 2009, TEP will be required to charge standard offer customers consistent with the formulation just
3 given. Other than TEP, the parties do not appear to believe that the MGC constitutes a "rate", rather
4 it is a mechanism used to calculate the Floating CTC by which TEP is currently collecting any
5 potential stranded costs. The parties other than TEP believe that the MGC will disappear at the same
6 time as the Floating CTC, i.e. December 31, 2008.

7 The pleading is fraught with additional instances of this kind of mischaracterization. It
8 indicates that..."The 2004 Rate Review confirmed that TEP is under-earning..." Staff certainly does
9 not agree with that statement. Nor does Staff agree with any assertion that TEP will be "entitled" to a
10 rate increase, or that the rate proceeding under consideration would involve a "return" to cost-of-
11 service generation rates. Rather than attempt to address every one of the misstatements, Staff would
12 prefer that the Judge and Commissioners treat TEP's pleading as a brief in support of TEP's positions
13 in the case. In the event that the agreement to process a rate case is not adopted, Staff will also be
14 submitting a brief in this matter. In the meantime, Staff asks that the Judge and Commissioners
15 consider the rate proceeding to which parties have agreed as the proper vehicle for parties to present
16 their views as to appropriate rate treatment for TEP.

17 **IV. MISCHARACTERIZATION OF THE PARTIES' AGREEMENT**

18 TEP mischaracterizes the nature of the agreement of the Parties in at least two ways. First,
19 TEP's pleading repeatedly refers to the upcoming proceeding as one in which it will be filing "rate
20 case information"; apparently distinguishing the proceeding from a rate case. The other, related
21 mischaracterization is the reference to the filing as being done "...to advance settlement negotiations
22 of the parties", presumably to again somehow distinguish this from a rate case.

23 In Staff's view, there should be no doubt as to the nature of the proceeding that is to be
24 undertaken. It is a rate case, intended to establish TEP's rates commencing January 1, 2009 or as
25 soon thereafter as possible. Staff does not see this proceeding as an informational exercise. TEP is a
26 public service corporation, subject to the authority of the Commission, and required to charge rates
27 established by the Commission.

Should TEP believe that the rates established by the Commission in the upcoming rate case are unjust, unreasonable, or unlawful, then TEP would have access to the courts as provided by A.R.S. §§ 40-253 and 40-254.01 as a means to remedy any deficiency that the court might find. Additionally, Staff has agreed that TEP should have the right to raise issues related to its 1999 Settlement Agreement and Decision No. 62103 in connection with any such litigation. Of course, just as TEP retains its right to claim that it is entitled to “contractual” damages, or other claims associated with its view of the effect of the Settlement and Decision No. 62103, the other parties to this proceeding retain their rights to dispute those claims and otherwise assert that TEP has no contractual claim. Furthermore, parties other than TEP should retain the right to assert that TEP has at all times been authorized just and reasonable rates under Decision No. 62103, that TEP was never authorized to charge “competitive” generation rates, that the MGC mechanism is a device for calculating stranded costs rather than a rate mechanism, and that the Track A Decision, as well as the *Phelps Dodge* case render TEP’s claims (if any) moot or satisfied. In sum, the rate case will decide the rates, and if necessary, litigation will address TEP’s claims relating to the intervening period between approval of the 1999 Settlement and the adoption of new rates in the upcoming rate case.

Nor should the rate case filing be construed as primarily a settlement device. Staff will be pleased to attempt to settle TEP’s rate case when it is filed. But, settlement discussions were unsuccessful in connection with this docket, and there does not appear to be any reason to reopen those discussions. Staff seeks to have TEP file a rate case in order to determine what just and reasonable rates might be for TEP at the conclusion of such a proceeding. We will gladly consider the alternative approaches to setting rates that TEP might propose. Staff makes no promises that it will find any of TEP’s alternative rate setting proposals acceptable. Staff does promise to propose rates in connection with the proceeding that we believe will be just and reasonable, providing TEP with the opportunity to earn a fair return on the fair value of its property devoted to public service.

V. SUBSTANTIVE DISAGREEMENTS WITH TEP’S PROPOSAL

The Parties to this docket have expressed a willingness to consider a process whereby TEP would continue to recover revenues associated with the Fixed CTC, even beyond the date when it

1 would ordinarily expire, until such time as the Commission is able to issue an order deciding the rate
2 case that is contemplated by this agreement. Staff's agreement to that process is expressly contingent
3 upon an understanding that any revenues collected by retaining the Fixed CTC beyond its ordinary
4 expiration date should be subject to refund, with interest, should the Commission so prescribe in the
5 upcoming rate case.

6 TEP has proposed to account for this agreement by modifying the MGC in an amount that
7 parallels the revenues that would otherwise be collected under the Fixed CTC. Staff does not
8 necessarily oppose this mechanism, however, it is necessary that several understandings be associated
9 with this modification. First, Staff does not believe that the proposed change to the MGC in any way
10 constitutes agreement that the MGC is a "rate", as previously suggested by TEP. Secondly, Staff
11 believes that any revenue collected by virtue of this device should be specifically tracked. Revenue
12 so collected should accrue interest at a rate equal to TEP's weighted average cost of capital as
13 established in its last rate proceeding, computed monthly on a compounded basis. Staff does not
14 oppose the 24 month refund period, but it should be clear that the unamortized balance would
15 continue to accrue interest as described above. Whether and how any refunds should occur should be
16 decided by the Commission in connection with the rate decision.

17 Finally, TEP should be required to submit detailed DSM proposals and a RES tariff as soon as
18 possible. DSM programs should be considered by the Commission and approved in an expeditious
19 manner. Program costs that exceed costs embedded in current rates should be capitalized, to be
20 recovered in rates in an amount and upon a schedule to be determined in the upcoming rate case.
21 RES costs should be treated consistently with other utilities' RES submittals. Any revenue neutral
22 TOU options should be submitted as soon as possible. Mandatory TOU rates, or TOU rates resulting
23 in increases to any customers should be submitted for consideration in the rate case.

24 VI. CONCLUSION

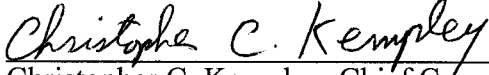
25 The parties to this proceeding have expressed a willingness to consider TEP's rate
26 alternatives. They have also expressed a willingness to have the Commission reserve a final decision
27 on the underlying issue of whether TEP is somehow entitled to commence charging market-based
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1 rates for its generation services. The parties have also expressed a willingness to allow rates to
2 remain unchanged, even after the date that the Fixed CTC will expire according to its own terms.

3 In exchange for these concessions, the parties to this proceeding have certain expectations.
4 First, and foremost, they expect TEP to submit a complete, cost of service rate case for all rate
5 elements, including all schedules required under A.A.C. R14-2-103. They also expect TEP to submit
6 complete information from which the Parties can analyze TEP's various proposed rate treatments.
7 For cost of service alternatives, this would anticipate inclusion of sufficient information to determine
8 the derivation of proposed rate schedules, including complete information in support of any proposed
9 regulatory asset. For market alternatives, this would include market studies supporting anticipated
10 rate levels. In addition, the market studies should illustrate a workably competitive market, including
11 sufficient transmission availability to support any such market based approach that the Commission
12 might adopt.

13 Finally, TEP should be expected to submit DSM proposals in sufficient detail and sufficiently
14 timely, to allow their adoption by the Commission as soon as possible. Procedures for capitalizing
15 costs incurred in excess of base rates, as well as possible refunds, with interest, are expected. TOU
16 proposals which would have the effect of raising rates should be submitted as part of the rate case.
17 RES proposals should be submitted in the same manner and time as other utilities' filings.

18 RESPECTFULLY SUBMITTED this 28th day of March, 2007.

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